



ECONOMIC PERSPECTIVES

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PROMOTING GROWTH THROUGH CORPORATE GOVERNANCE



ECONOMIC PERSPECTIVES

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Promoting Growth Through Corporate Governance

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ABOUT THIS ISSUE

A series of high profile corporate financial scandals in the United States and elsewhere has focused attention on the consequences of poor corporate governance. At the same time, increased demand for investment capital has made companies and countries worldwide look to good governance as a means of attracting and keeping investors.

Broadly speaking, “corporate governance” refers to the rules that guide the behavior of corporations, shareholders, and managers, as well as to government actions to promote and enforce those rules. Corporate governance provides the basis for a stable and productive business environment. It can be especially important in emerging markets and to firms that seek to distinguish themselves in the global economy, says corporate governance expert Ira Millstein in the introductory overview to the journal.

In the United States, financial scandals prompted a comprehensive overhaul of laws covering business behavior, in the form of the Sarbanes-Oxley Act of 2002. Ethiopis Tafara and Robert Strahota of the U.S. Securities and Exchange Commission (SEC) describe SEC cooperation with overseas regulators to help foreign firms deal with the strict new standards the Act imposes. And U.S. Department of Justice official Christopher Wray says that Sarbanes-Oxley has given prosecutors a larger arsenal of tools with which to prosecute corporate wrongdoers.

In other countries, particularly those in the developing world, good corporate governance may require transforming political and economic governance arrangements from relationship-based systems to rules-based systems, say Charles Oman and Daniel Blume of the Organization for Economic Cooperation and Development (OECD). The U.S. Agency for International Development (USAID) explains how, to promote this transformation, it has

partnered with the Center for International Private Enterprise (CIPE) to support corporate governance development projects overseas that combine local knowledge with international principles.

Other articles in the journal discuss business education and the teaching of ethical management practices across national borders, corporate governance within the context of family-owned businesses, the role of shareholders in the corporate decision-making process, and how one major pharmaceutical company, Pfizer Inc., has found that “Doing business with integrity is good for business.”

This issue of *Economic Perspectives* aims to give readers an overview of the principles of corporate governance, current trends in U.S. and international policies affecting businesses and business managers, and the work that is being carried out by governments and businesses alike to create a more transparent and accountable corporate environment.

The Editors



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LAYING THE GROUNDWORK FOR ECONOMIC GROWTH

Ira M. Millstein



Solid corporate governance is becoming increasingly crucial to attracting investment capital. Developing countries in particular stand to gain by adopting systems that bolster investor trust through transparency and rule of law.

Photo above: Investors grant the power to run the corporation to the board of directors, a group of people entrusted with the task of making decisions in the best interests of the company and all its investors. © Jose Luis Pelaez, Inc./CORBIS

Ira M. Millstein is senior partner with the law firm Weil, Gotshal & Manges LLP, and a visiting professor in Competitive Enterprise and Strategy at the Yale School of Management. He chairs the Private Sector Advisory Group of the Global Corporate Governance Forum founded by the World Bank and the Organization for Economic Cooperation and Development (OECD). Mr. Millstein thanks Rebecca C. Grapsas, an associate at Weil, Gotshal & Manges LLP, for contributing valuable input and insights for this article.

Corporate governance is entering a phase of global convergence, driven by the growing recognition that countries need to attract and protect all investors, both foreign and domestic. The equation is clear: global capital will generally flow at favorable rates to where it is best protected, but will not flow at all or will flow at higher-risk rates where protections are uncertain or nonexistent.

In many countries whose legal systems are rooted in British common law, the interests of shareholders are held to be paramount in most corporate decisions. However, this has not been the case throughout the rest of the world—at least not until now.

Countries that have traditionally fostered notions of partnerships between management, employees, and other stakeholders, have other social priorities, or have mixed government-private ownership arrangements are now recognizing investor protection as an important signal to potential capital providers. This is especially the case for developing countries. They need to demonstrate adoption of corporate governance principles so as to foster investor trust and attract capital, which will in turn lead to investment and economic growth. Of course, these principles need to be tailored to fit local needs—one size

will not fit all. But there are certain fundamentals that cannot be ignored.

Corporate governance comprises a combination of regulatory rules and private sector-driven guidelines. In countries with more sophisticated financial markets, corporate governance rules and structures are contained in laws protecting property rights and shareholder rights through legislation, accompanying regulations, judicial decisions, and stock exchange listing rules. This is the essential enabling governmental infrastructure. In addition to formal rules, corporations adopt best-practice principles and guidelines, which are continually being developed by the private sector and academia in response to prevailing market conditions and investor demands. Developing countries need to take both elements—governmental infrastructure and best practices—into account.

THE ROLE OF THE CORPORATION

Understanding corporate governance requires an understanding of the concept of the corporation and the position it occupies in the business world. This understanding will demonstrate why corporate governance, as I have described it, is essential to legitimizing the corporation's role in society and providing a vehicle for economic growth.

The corporation is an entity created by law. It has existed in some form or another for hundreds of years, and its essential features have stayed virtually the same over that whole period.

One of the most important features of a corporation is limited liability, which allows people to invest money or other property in the corporation without any of their other personal assets being placed at risk in the event the company fails. This money is locked away in the company, and investors are denied any sort of meaningful access to it. For example, they cannot demand that the company pay a dividend or give back any of the capital. Their capital is at risk because while the investors profit if the corporation succeeds, they can lose it all if the corporation fails. After contributing money or other property to a company, investors are issued shares, which represent the entitlement to a reward for assuming this risk. In most cases, shares are freely transferable, so shareholders can sell their shares to other investors. Or they can “walk away” from a corporation entirely if they wish.

Another key feature of a corporation is perpetual existence. The corporation's ability to continue

indefinitely gives stability to the enterprise by ensuring that businesses can survive their founders.

The corporation became the dominant form of business organization in response to a need for growth capital. It is the most efficient way to amass large amounts of capital. Shareholders are able to invest in companies without risk of personal liability and do not need to rely on the reputation or trustworthiness of their fellow investors as they would in a partnership. They can also spread their risk by investing in a number of different companies, with the aim of maximizing their overall return.

THE BOARD OF DIRECTORS

In exchange for the benefits of limited liability, perpetual life, and transferability of shares, investors grant the power to run the corporation to a group of people entrusted with the task of making decisions in the best interests of the company and all of its investors, not just a particular segment of investors. In this way, the corporation is not directed by special-interest investors, and the shareholders are protected against one another's unique agendas. This group of entrusted people, elected by shareholders, is called the board of directors.

Much of the law regulating corporations relates to the board of directors, with many of the specific rules designed to foster investor confidence that directors will do the right thing. The board is responsible for managing or directing the business and affairs of the company. In practice, the board delegates its authority to make day-to-day decisions concerning the operation of the company to full-time employees. Boards appoint a chief executive officer (CEO) to coordinate and oversee these management efforts, and the CEO, in turn, is empowered to hire the top managers.

But the interests of shareholders, directors, and managers can sometimes conflict. For instance, some shareholders may wish to receive a dividend, while other shareholders and management may prefer to reinvest profits and promote internal corporate growth. The board is required to manage these conflicting interests by making decisions in the best interests of the company and all of its shareholders.

CONVERGING MODELS OF CORPORATE GOVERNANCE

In many common-law countries, shareholders are the constituents to whom directors have primary regard in the decision-making process. Other countries such as

France, Germany, and the Netherlands have historically placed emphasis on the interests of other stakeholders, including employees, creditors, customers, suppliers, and the community in which the corporation operates. The current corporate governance climate is tending toward convergence of these models.

Investor interests are increasingly paramount as a result of the global nature of modern investments, the rise of the institutional investor as a dominant player, and the related focus on protecting investment—regardless of where the corporate headquarters are located. Moreover, corporate boards are increasingly aware of the need to treat nonshareholder constituents fairly and have regard for their interests so that the corporation can succeed financially, as well as live up to the demands for social responsibility placed on it by those stakeholders and others. The convergence is thus from both sides. For example, when Johnson & Johnson, a pharmaceutical manufacturer, immediately and voluntarily removed all possibly tampered-with bottles of Tylenol from distribution, it showed responsibility beyond the bottom line.

Accountability to shareholders and the other stakeholders is assured by a set of duties—spelled out to one degree or another in many developed countries—with which directors must comply in making decisions. These duties are known as fiduciary duties. They include the duty to exercise care, the duty to be loyal to the company, the duty to be candid and transparent, and the duty to act in good faith. A breach of any one of these duties can result in potential director liability to either government regulators or shareholders. In the United States, for example, shareholders may institute lawsuits against directors in their own right or on behalf of the company to gain redress for an alleged breach of fiduciary duty. Such cases abound in the United States, as witness the host of shareholder suits against Enron, Tyco, and WorldCom, among many others. Some suits have merit and some not, but the possibility of such suits is a strong motivation for better director performance.

Shareholders can also do the “Wall Street walk” and sell their shares if they are unhappy with what is happening at the company. And regulators can step in for more egregious behavior. In other countries, the existence and enforceability of these directors’ duties vary significantly. But it is also becoming clear that duties without enforceability may be hollow.

RISK TAKING AND ACCOUNTABILITY

It might be reasonable to wonder whether directors would be comfortable making decisions that might result in good returns to the company but that are either inherently risky or uncertain. The law assists directors in this regard by freeing them of liability for their decisions, provided they act in good faith and with care and diligence. In the United States, for example, this is achieved by means of court-made law. In addition, companies can assume the costs of defending directors who act in good faith, and they can also purchase insurance to cover such costs. All of this works together with the duties outlined above to reduce the risk of mistakes without sacrificing economic efficiency in decision making.

To illustrate, consider this scenario: The board of a gold mining company is deciding whether to purchase an expensive license to prospect in an area that has a 20 percent chance of yielding valuable gold deposits. A risk-averse group of directors might reject the opportunity if there were a possibility that shareholders could sue them if it were discovered that there were no deposits. Decisions such as those, at an aggregate level, would be disastrous for business because fearful directors might make many economically inefficient decisions. Once the specter of personal liability is removed, those same directors should be more likely to make more efficient decisions. This overall system protects directors under what is known as the business judgment rule. Courts will protect directors who use business judgment in good faith and with care and diligence.

NOURISHING INVESTOR TRUST

The legal requirements relating to directors form part of a larger framework aimed at nourishing investor trust in the corporate form. Many of these are structural in nature, including those ushered in by the corporate governance reforms of recent years, such as mandatory director independence, committee structures requiring independent directors to meet alone without management present in order to discuss frankly and openly whatever they wish, and an active audit committee.

Recently, the corporate governance movement has begun to focus on other ways of bolstering the integrity of directors and managers. For instance, U.S. Securities and Exchange Commission Chairman William Donaldson has emphasized the importance of directors and senior management setting the right tone at the top in terms of high ethical standards. Going forward, the

corporate governance movement will be striving to find directors with a moral compass who are endowed with qualities revered by 18th-century economist Adam Smith, such as prudence, justice, beneficence, temperance, decency, and moderation. Boards comprising people possessing at least some of these qualities should foster investor trust in the board and the corporation. Moreover, directors with a demonstrable moral compass should be more inclined to make risky but efficient decisions, since courts will be less likely to impose liability upon such persons.

The existence of a solid corporate governance regime will be important to an individual investor's decision whether to buy shares in a company. Investors are unlikely to want to commit their funds to a corporation whose board and management cannot be trusted to do the right thing for all the shareholders. The decision of each potential investor to invest or not invest in a company can be aggregated at the national level to illustrate the importance of corporate governance on a macro scale. If a country or region has a demonstrable governance infrastructure, public and private, its overall economy will benefit from increased local and domestic investment.

BRAZIL'S EXPERIENCE

Recent reforms in Brazil provide a useful illustration of how investor trust in the integrity of the corporation as an institution can be a crucial ingredient in the growth of capital markets. A reform program was begun at the Brazilian stock market in October 2000 after years of stagnation. In less than a year, a second market, called the Novo Mercado, was launched. The Novo Mercado prescribes strict corporate governance standards as a

prerequisite to listing and has been successful in attracting investment. Corporate governance measures such as those instituted by the Novo Mercado strengthened investor confidence in the integrity of the corporate form and those who are overseeing their investment. For instance, rules regulating transactions involving a conflict of interests have promoted a transparent environment and well-informed market participants. In addition, governance measures that protect the rights of shareholders have ensured that directors and managers are accountable to investors.

The Novo Mercado demonstrated the importance to investors of openness, transparency, and the existence of good corporate governance. The lesson is not restricted to countries with stock exchanges—it applies to any corporation and country seeking new capital for growth from the increasingly sophisticated global capital markets. And it applies equally to other providers of capital such as banks, which can improve their local economies by improving both their own corporate governance, thereby attracting deposits, and the governance of borrowers, by extending loans to those borrowers with demonstrable good governance.

Developing countries can look toward corporate governance models such as those in place elsewhere in the world for guidance in crafting and instituting local corporate governance rules and principles. In the global capital market, these rules and principles can serve to bolster investor trust in the local corporate form that will ultimately lead to economic growth and prosperity. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

FOSTERING AN INTERNATIONAL REGULATORY CONSENSUS

Ethiopsis Tafara and Robert D. Strahota



More than 1,200 foreign companies file reports with the U.S. Securities and Exchange Commission and are thus affected by changes to U.S. law, including the Sarbanes-Oxley Act of 2002. To ease the path to compliance for those and other firms, U.S. regulators have been working with their foreign counterparts and the business community to remove barriers and reconcile differences in national standards and practices.

Photo above: President Bush speaks to business leaders on Wall Street outlining his agenda for corporate reform. (©AP/WWP Photo/Kathy Willens)

Ethiopsis Tafara and Robert D. Strahota are director and assistant director, respectively, of the U.S. Securities and Exchange Commission's Office of International Affairs. The views expressed are those of the authors and do not necessarily reflect the views of the Commission, other commissioners, or the staff of the Commission.

The Sarbanes-Oxley Act is the most comprehensive and important U.S. securities legislation affecting public companies and independent accountants since the Securities and Exchange Commission (SEC) was created in 1934. The broad reforms in the act address disclosure and financial reporting by public companies, corporate governance, and auditor oversight. But what is especially striking is the interest, concern, and debate that the act has generated outside the United States. When the SEC was created, no one could have imagined that revisions to the U.S. securities laws could have such an impact abroad. Today, the more than 1,200 foreign companies that file reports with the SEC represent nearly 10 percent of all SEC reporting companies. Some of these companies' shares are among the most actively traded on U.S. markets.

More than ever, capital markets around the world are interdependent, and changes to national laws can have repercussions outside of borders.



Rep. Michael Oxley, left, and Sen. Paul Sarbanes, co-sponsors of the United States' corporate governance overhaul, speak to reporters outside the White House. (©AP/WWP Photo/Ron Edmonds)

THE SARBANES-OXLEY REFORMS

The principal reforms contained in Sarbanes-Oxley generally can be grouped into three categories. First, the act includes important reforms aimed at improving the performance of and restoring confidence in the accounting profession. It ends self-regulation of the accounting profession where the audit of public companies' financial statements is concerned. In its place, it creates the Public Company Accounting Oversight Board, an independent private sector body that, in turn, is subject to SEC oversight.

Second, the act provides new tools to enforce the securities laws. The Securities and Exchange Commission has been using those tools to broaden the scope of its enforcement program. Over the past two fiscal years, the commission has filed more than 1,300 enforcement actions, more than 370 of which involved financial reporting and accounting frauds. We have obtained orders for penalties and repayment of ill-gotten gains totaling nearly \$5 billion, and have sought to bar more than 330 executives from serving again as officers or directors of public companies.

Third, the act mandates new requirements designed to improve public companies' disclosure and financial reporting practices. The provisions concerning chief executive officer (CEO) and chief financial officer (CFO)

certifications of reports containing financial statements, including the adequacy of disclosure controls and procedures, are intended to leave no doubt as to senior management's responsibilities for financial reporting. Also in this category are the provisions that are currently receiving the most attention from companies and auditors—the requirements for an annual management report on and audit of companies' internal control over financial reporting.

NATIONAL BOUNDARIES AND CONCERNS OVER SOVEREIGNTY

While Sarbanes-Oxley represents a U.S. legislative response to the financial failures of U.S. companies such as Enron and WorldCom, the financial problems that have come to light in non-U.S. companies, such as Ahold, Parmalat, Royal Dutch Shell, and Vivendi, confirm that the issues that the act was intended to address transcend national boundaries.

Today, lawmakers and regulators around the world are actively working to improve corporate governance, auditor oversight, and other aspects of the financial reporting process. There is a fast-developing international consensus on many critical goals, as illustrated in statements by the International Organization of Securities Commissions on the reporting of price sensitive information, management's discussion and analysis of financial statements, auditor independence, and auditor oversight. Many jurisdictions, including some European Union (EU) member states, are undertaking efforts to reform their auditor oversight systems, and the EU has announced Priorities for Improving the Quality of Statutory Audits in its member states. Additionally, the 2004 amendments to the Organization for Economic Cooperation and Development's Principles of Corporate Governance place increased emphasis on the role of independent directors and audit committees in the financial reporting process.

Although the SEC shares the above regulatory goals with our foreign counterparts, we have recognized from the outset that certain aspects of the Sarbanes-Oxley Act raise potential conflict of laws and sovereignty concerns for some non-U.S. regulators and market participants. The U.S. Congress was clear that the act generally should make no distinction between domestic and foreign companies. Certainly, U.S. investors transacting on U.S. markets are entitled to the same protections regardless of whether the issuer of a security is foreign or domestic.



Securities and Exchange Commission Chairman William Donaldson testifies before the Senate Banking Committee on Capitol Hill. (©AP/WWP Photo/Dennis Cook)

At the same time, the SEC recognizes that its rules applicable to non-U.S. market participants must be implemented in a reasonable and measured way that fosters cooperation and consensus building. One of the greatest challenges that the commission has faced in implementing Sarbanes-Oxley is to fulfill our congressional mandate while respecting potential conflicts with foreign laws and regulations. Our willingness to address foreign concerns is a testament to the importance that we place on open dialogue and to the strong relationships we have with our non-U.S. counterparts.

ACCOMMODATING NON-U.S. FIRMS

Among the most important of the Sarbanes-Oxley reforms are those that address the role of the audit committee of the board of directors in overseeing accounting, auditing, and financial reporting. The SEC's approach toward implementation of the audit committee requirement for listed companies is an example of our efforts to address potential conflicts and to accommodate different, non-U.S. regulatory requirements.

The act required the commission to adopt a rule directing the national securities exchanges and the National Association of Securities Dealers to prohibit the listing of any security of an issuer that is not in

compliance with the audit committee requirements mandated by the act. All members of the audit committees of listed companies must be independent directors, and audit committees must be directly responsible for the appointment, compensation, and oversight of the issuer's independent accountants.

Based on a consideration of potentially conflicting non-U.S. legal requirements raised by foreign commenters, the SEC's rule includes certain accommodations for foreign private issuers that take into account foreign corporate governance schemes, while preserving the intention of the act to ensure that those responsible for overseeing a company's outside auditors are independent of management. These accommodations:

- allow nonmanagement employees to serve as audit committee members, consistent with some countries' requirements for employee representation on the board of directors;
- allow shareholders to select or ratify the selection of auditors, also consistent with requirements in many countries;
- allow alternative structures, such as statutory auditors or boards of auditors, to perform auditor oversight functions where they are authorized by home country requirements, they are not elected by management of the issuer, and no executive officer of the issuer is a member;
- allow for foreign government representation and controlling shareholder nonvoting representation on audit committees, provided the representatives are not members of management.

Some observers do not believe that the Securities and Exchange Commission has gone far enough in accommodating non-U.S. market participants, and they have called for exemptions based on principles of mutual recognition. Of course, we respect those views, but we believe that the SEC, as well as any other national regulator, has the sovereign right to determine the terms and conditions under which companies and their representatives may access investors in its jurisdiction. The real challenge is to do so in a reasonable manner and on an equitable basis that fosters international acceptance.

CHALLENGES FACING FOREIGN FIRMS

Though the Sarbanes-Oxley Act does not provide an exemption for foreign private issuers, the SEC will continue to be sensitive to the need to accommodate unique foreign structures and requirements. Many non-U.S. companies and their auditors are currently working hard and are well on their way to completing

the processes necessary to report on internal controls. We recognize that the internal control disclosure provisions of the act are the most difficult and expensive to implement. However, of all the reforms contained in the act, getting these processes right may have the greatest long-term impact on improving the accuracy and reliability of financial reporting. But for non-U.S. companies, in some cases, these reforms require significant rethinking of the control environment. This is one of the reasons that the commission extended the compliance date for non-U.S. companies to fiscal years ending on or after July 15, 2005.

Subsequently, the commission has taken steps to provide additional time for certain U.S. companies with less than \$700 million of unaffiliated market capitalization to comply, and we intend to be sensible in addressing the requirements for non-U.S. issuers as well. Perhaps most important, many companies abroad, especially in Europe, face additional challenges in the near term that go above and beyond those faced by U.S. companies as they adopt international financial reporting standards for the first time in 2005. To address these burdens, the commission has proposed amendments to our reporting requirements that would facilitate foreign private issuers' conversion to International Financial Reporting Standards (IFRS). We will continue to monitor progress in these areas. We are prepared to reach out and engage in an open dialogue to address concerns regarding both internal controls and IFRS implementation.

EXPANDING THE SHAREHOLDER SOCIETY

Our regulation of U.S. markets and our foreign counterparts' regulation of their markets is part and parcel of a broader issue: the movement of millions of people throughout the world into what has been called

“the shareholder society.” Today, more than 13 million households in India are directly invested in debt or equity shares. There are believed to be approximately 60 million active equity investors in China. Share ownership creates new opportunities to accumulate savings and wealth and to put capital to use in entrepreneurial ventures that are the lifeblood of growing economies.

The fundamental issue for everyone involved in financial markets, regardless of company or country, must be to maintain high standards that foster trust and confidence. Investors can—and do—move capital around the globe with a few keystrokes on a computer. Capital will flee environments that are unstable or unpredictable—whether that's a function of lax corporate governance, ineffective accounting standards, or a lack of transparency. Investors must be able to see for themselves that companies are living up to their obligations and embracing the spirit of all securities and governance requirements.

One of the highest priorities for the United States and for the SEC is helping to foster the growth of capital markets and the multiple benefits that flow from dynamic markets and enlightened corporate governance. These benefits help to reduce the cost of capital and provide a more stable platform for long-term economic growth. These conditions, in turn, spark prosperity and create opportunities for investors to achieve higher returns. Only with the widespread acceptance of these values will our capital markets maintain their rightful place as an engine of prosperity in the United States and throughout the world. ■

PROSECUTING CORPORATE CRIMES

Christopher Wray

The U.S. Department of Justice is moving decisively to address corporate criminal behavior, using the tools provided by the Sarbanes-Oxley Act of 2002 to crack down on corporate officials and other professionals who abuse their positions to enrich themselves at the expense of all other stakeholders.

Strategies and policies for combating corporate crime are set by the Corporate Fraud Task Force, created by President Bush in 2002 following a wave of corporate scandals in the United States. The task force comprises both a Justice Department group that focuses on enhancing the criminal enforcement activities within the department, and an interagency group that works to maximize cooperation and enforcement throughout the federal law enforcement community. Recent prosecutions illustrate the department's new and aggressive approaches to fighting business-related crime.

Christopher Wray was confirmed on September 11, 2003, as the assistant attorney general of the Criminal Division of the U.S. Department of Justice. He has been with the department since 2001, handling a variety of federal cases and investigations, including for securities fraud, public corruption, racketeering, counterfeiting, and immigration.

Corporate crimes injure investors, employees, and the capital markets that fund the needs of existing firms and promote new businesses. Recent revelations of corporate fraud and other crimes have increased the need to investigate and prosecute criminal activity conducted by corporate officials—and associated professionals—who have abused their positions to enrich themselves while breaching the trust of investors, employees, financial institutions, and the capital marketplace.

The prosecutions for corporate fraud and related misconduct have demonstrated that criminal activity has permeated the highest levels of several major publicly held corporations, brokerage firms, accounting and auditing firms, and others. A few dishonest individuals have damaged the reputations of many honest companies and executives. These wrongdoers injured workers who dedicated their lives to building the companies that hired them. They hurt investors and retirees who had entrusted their financial futures when they placed their faith in the promises of the companies' growth and integrity.

These revelations of a corporate culture of corruption and deception in a number of very prominent corporations have threatened to undermine the public's confidence in corporations, the financial markets, and the economy. They also have magnified the need for a renewed emphasis on effective corporate governance.

ENFORCEMENT ACTIVITIES

To address these and other abuses revealed by recent corporate fraud scandals, such as those related to Enron, WorldCom, HealthSouth, and Adelphia, President George Bush created the Corporate Fraud Task Force in July 2002. The task force, chaired by the deputy attorney general of the Department of Justice, comprises members of the department assigned to enhance criminal enforcement activities within the department, and an interagency group of investigative and regulatory agencies that concentrates on maximizing cooperation and joint regulatory, investigative, and enforcement activities throughout the federal law enforcement community in matters of federal corporate fraud.

The current wave of corporate fraud prosecutions focuses on a variety of criminal conduct, including falsification of corporate books and records, distribution of fraudulent financial statements to the public and to regulatory authorities, creation of “off-the-books” accounts and relationships to conceal fraudulent activity, abuse of high corporate positions for personal benefit at the expense of the corporation, and insider trading. Often, related charges are brought for obstructing and compromising audits and investigations related to fraudulent misconduct, destruction or alteration of corporate records, perjury before grand juries and investigative authorities, and related criminal activity.

On the legislative front, the U.S. Congress passed the Sarbanes-Oxley Act in July 2002. The act constitutes the most comprehensive reform of U.S. business practices in 60 years. It gives prosecutors and regulators new means to strengthen corporate governance, to improve corporate responsibility and disclosure, and to protect corporate employees and shareholders.

The act requires, upon pain of imprisonment, that the most senior officers of a corporation certify that the firm’s financial statements truly and accurately reflect its financial condition and result of operations; that auditors exercise their responsibilities to provide an independent examination and certification of the accuracy and reliability of a corporation’s financial statements; that employees are protected from retaliation for disclosing improprieties of corporate officials; and that the corporate information available to investors is true and accurate, and free from deception.

INNOVATIVE TOOLS

Recent investigations and prosecutions of corporate fraud cases have been expedited by the use of some of the new tools provided to prosecutors by the Sarbanes-Oxley Act and by strategies and policies developed by the Corporate Fraud Task Force. These innovations include the following:

- **Bringing the collective resources and expertise of federal agencies to bear earlier in an investigation in order to complete the investigation and initiate prosecution more expeditiously.** This frequently means using the resources of regulatory agencies, such as the Securities and Exchange Commission (SEC), to conduct a joint investigation of corporate misconduct from the inception of an investigation, instead of awaiting completion of the SEC proceedings before commencing a criminal investigation.
- **Segmenting complex investigations into smaller, more manageable portions that can be investigated and prosecuted promptly and are more understandable to investigators, prosecutors, and juries.** A more

narrowly defined criminal investigation often encourages corporate officers and others who are involved in fraudulent conduct to enter plea agreements. A plea agreement is a formal agreement for the disposition of criminal charges between the prosecutor and the defendant pursuant to which the defendant agrees to plead guilty to one or more charges of an indictment or information and the prosecutor agrees to do certain things, such as not to

bring or move to dismiss other charges or recommend to the court that a particular sentencing disposition is appropriate under the circumstances. Consequently, instead of spending years investigating a complex scheme of corporate fraud—as would have been the case only a few years ago—cases are now more often investigated and prosecuted in months.

- **Using aggressive and innovative means to obtain corporate cooperation before criminal charges are instituted.** Usually, the issue of corporate cooperation is intertwined with the criminal liability of the corporation itself. Increasingly, corporations are held accountable through full prosecutions or negotiated resolutions. A corporation or other organization may be fined, placed on probation and ordered to make restitution, and ordered to notify the public and their



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CORPORATE FRAUD PROSECUTIONS

Recent corporate fraud prosecutions illustrate the Department of Justice's new approaches to investigating and prosecuting corporate fraud.

ENRON CORPORATION

The Department of Justice's Enron Task Force has brought charges against 33 defendants, including 24 former employees of the energy company, among them, the chairman of the board, two chief executive officers (CEOs), the chief financial officer (CFO), a treasurer, three CEOs of prominent business units within Enron, the executive vice president for Enron's investor relations, and a corporate secretary. Of those defendants, 22 have pleaded guilty or been found guilty after trial, including the former CFO, and more than \$161 million in ill-gotten gains have been seized. Most recently, in November 2004, a jury convicted five executives of Enron Corporation and Merrill Lynch & Co., Inc., a financial management firm, of fraud, perjury and obstruction of justice charges arising out of a sophisticated and complex financial fraud scheme.

As in all aspects of the overall Enron investigation, there was close coordination between the Department of Justice and the Securities and Exchange Commission (SEC). Merrill Lynch settled civil charges with the SEC and entered into a deferred prosecution agreement with the Department of Justice that provides for Merrill Lynch to adopt a number of sweeping reforms and to appoint a monitor to assure the department and the court that the company is abiding by its agreement to institute and comply with the agreed-upon reforms.

HEALTHSOUTH CORPORATION

The former CEO and chairman of the board of HealthSouth, a health care services provider, was indicted on numerous charges of fraud arising out of a scheme to artificially inflate HealthSouth's publicly reported earnings and value of its assets and to falsify reports of the company's financial condition. The defendants allegedly added \$2.7 billion in fictitious income to the company's books and records and induced the company to pay themselves salaries, bonuses, stock options, and other benefits based upon the fraudulently inflated figures.

Seventeen former officers of HealthSouth, including five former CFOs, have pleaded guilty to felony charges in connection with the scheme and have agreed to cooperate in the investigation and trial. This case developed in coordination with SEC enforcement actions.

ADELPHIA COMMUNICATIONS CORPORATION

The former CEO and CFO of Adelphia Communications, a cable television company, were convicted by a jury of conspiracy, securities fraud, and bank fraud arising from a complex financial and accounting fraud scheme and of embezzlement of corporate property that defrauded Adelphia's shareholders and creditors. The investigation and prosecution of this case were closely coordinated with the SEC, which also instituted a parallel enforcement action.

PNC FINANCIAL SERVICES GROUP/AMERICAN INTERNATIONAL GROUP (AIG)

These related cases, involving the fraudulent use of special-purpose entities, exemplify the use by the Department of Justice of deferred prosecution agreements to address corporate wrongdoing. In these cases, the financial companies engaged in a scheme to utilize the special-purpose entities to offload more than \$750 million in problem loans and investments from PNC's books to the special-purpose entities. Under the deferred prosecution agreements, the Department of Justice defers prosecution, essentially providing for a term of corporate probation requiring complete cooperation, prospective internal reforms, retrospective review of particular financial transactions, and punitive measures, including penalties and restitution.

victims about their criminal wrongdoing. A condition of probation may require the corporation to take actions to remedy the harm caused by the offense and to eliminate or reduce the risk that the harm will occur in the future.

The Department of Justice is also increasingly using *deferred prosecution agreements*, a less punitive option with reduced collateral harm. These agreements typically provide for the filing of criminal charges with an agreement that those charges will be dismissed after a period of time if the company lives up to its obligations. The agreements usually provide for the company to accept responsibility by acknowledging the acts of its employees, make restitution and surrender ill-gotten financial gains, install effective compliance programs, employ an independent monitor to review future activities, and commit to fully cooperating with the government in its investigation of culpable individuals. A court may add to the fine any gain to the corporation from the offense that has not and will not be paid as restitution or by way of other remedial measures. Any breach of the agreement by the company would subject it to a full prosecution.

On other occasions, the Department of Justice has entered into *cooperation agreements* with companies. These agreements can encompass most of the attributes of a deferred prosecution, but they do not involve an actual legal action in court. The cooperation agreements allow the company to avoid any potential collateral consequences associated with the mere fact that the

company has been charged with a crime, but they still require acceptance of responsibility, restitution and surrender of ill-gotten gains, full cooperation, and implementation of remedial measures.

- **Prosecuting those who facilitate fraud and obstruct investigations, either in separate criminal proceedings or in the underlying corporate fraud prosecution.**
- **Aggressively pursuing civil and regulatory enforcement action, often in proceedings parallel to criminal prosecutions and investigations.** This ensures that enforcement actions will be promptly initiated and actively pursued to protect investors and consumers from corporate fraud.

RESTORING PUBLIC CONFIDENCE

Much has been accomplished in the Department of Justice's ongoing campaign against corporate fraud; however, much remains to be done. In order to restore full public confidence in the financial markets, continued strong enforcement will be necessary to increase the level of transparency of corporate conduct and of financial reporting and to strengthen the accountability of corporate officials. ■

CORPORATE GOVERNANCE: THE DEVELOPMENT CHALLENGE

Charles Oman and Daniel Blume



Developing countries face the challenge of transforming political and economic governance arrangements from relationship-based systems into rules-based systems. Many must enhance their ability to address corporate insiders' abusive use of schemes to expropriate or divert resources from other stakeholders. With enforcement at the heart of the challenge, the appropriate balance between regulatory and voluntary initiatives remains an open question.

Photo above: The Organization for Economic Cooperation and Development (OECD), meeting here at its Paris headquarters, sets global standards for transparent and accountable business practices. © OECD Photo

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Recent spectacular corporate governance failures in the United States and Europe remind us that such breakdowns can severely affect the lives of thousands—employees, retirees, savers, creditors, customers, suppliers—in countries where market economies are well developed. But is corporate governance important in the developing world, including so-called emerging-market and transition economies, where national economies tend to be dominated by large family-owned, state-owned, and/or foreign-owned companies that do not have shares widely traded on local stock markets and where a multitude of small noncorporate forms of enterprise often account for a significant proportion of local employment and output? Until recently, few people thought so.

Only after the financial crises of 1997-1999 in Asia, Russia, and Brazil did heightened concern for global financial stability draw attention to the problems of “crony capitalism” and poor corporate governance in some emerging-market economies. Since then, the perceived threat to global financial markets and the pressures engendered by that perception have waned. The danger is that local efforts to enhance corporate governance in the developing world will lose momentum as a consequence.

Instead, those efforts need to be strengthened. Research by the Organization for Economic Cooperation and Development (OECD) on the importance of local corporate governance for sustained productivity growth in the developing world, as well as the OECD's regional corporate governance roundtables in Asia, Latin America, Eurasia, Southeast Europe, and Russia, show that the quality of local corporate governance is critically important for the success of long-term development efforts throughout the developing world today.

RULES AND RELATIONSHIPS

A country's system of corporate governance comprises formal and informal rules, along with accepted practices and enforcement mechanisms, private and public. Taken together, these govern the relationships between the people who effectively control corporations (corporate insiders) and those who invest in them. Well-governed companies with actively traded shares should be able to raise funds from noncontrolling investors at significantly lower cost than poorly governed companies because of the premium potential investors can be expected to demand for taking the risk to invest in less well-governed companies.

Corporate governance continues to be seen by some as relatively unimportant in developing countries, in large part because of the small number of firms there with widely traded shares.

The poor quality of local systems of corporate governance lies at the heart of one of the greatest challenges facing most countries in the developing world: how to successfully—often in the face of covert or overt resistance from powerful, locally entrenched interest groups—transform local systems of economic and political governance, including those of corporate governance, from systems that tend to be highly personalized and strongly *relationship* based into systems that are more effectively *rules* based.

In many of today's OECD countries, the transformation from predominantly relationship-based to rules-based systems of economic and political governance took place largely before the spectacular rise and rapid global spread late in the 19th century of the giant manufacturing corporation and the displacement of proprietary capitalism (unincorporated individually owned business) by global corporate capitalism.

Today's developing countries thus face a challenge unknown to many OECD countries: how to move from relationship-based to rules-based systems of governance at

a time when large private- and state-owned corporations play significant roles in local economies (whether or not their shares trade actively in a local stock market) and therefore tend strongly to influence local systems of governance.

OLIGOPOLISTIC RIVALRY AND CORPORATE INSIDERS

The importance and difficulty of this challenge are reflected in the pervasiveness of two often mutually reinforcing phenomena in the developing world. One is the considerable extent to which corporate insiders are able to manipulate the economic environment to extract financial income not matched by corresponding labor or investment. Insiders display a predictable reluctance to divulge information needed to measure the values of their corporations. Nevertheless, the difference between the price paid for a controlling bloc of a company's shares and the price others paid for the shares in the open market can be used as an objective indicator of those values. During the 1990s, the difference averaged 33 percent in Latin America and 35 percent in central European transition economies, for example, as contrasted with 2 percent in South Africa, the United States, and the United Kingdom, and 8 percent in non-Anglo-Saxon Europe.

The other phenomenon is the impact of oligopolistic rivalry among powerful interest groups entrenched in local structures of economic and political power. (An oligopoly is a market with so few suppliers that the behavior of any one of them will affect price and competition.) Such groups are sometimes called distributional coalitions because of their tendency to spend significant financial, physical, and human resources in attempts to defend and/or expand their bases for value extraction rather than invest resources in the creation of new wealth for their national economies and themselves. They generally include insiders in major private and public corporations.

STRATEGIES OF OWNERSHIP

Three techniques are widely used by insiders throughout the developing world to expropriate or divert resources from corporations in ways that deprive noncontrolling investors and other corporate stakeholders of wealth that would be considered their fair share in countries with sound corporate governance. Most important is the use of *pyramidal corporate ownership structures* in which one firm holds a controlling equity

share in one or more other firms (the “second layer”), each of which, in turn, holds a controlling share of one or more other firms (the “third layer”). Such pyramids allow insiders who control the company at the top to effectively control the resources of all the firms in the pyramid, even though their nominal ownership of all those other firms, especially in the lower layers, may be quite small.

Also important are *cross-shareholdings* (firms that possess each other’s shares) and *multiple share classes* (shares in the same company that have different voting rights, with insiders’ shares having disproportionately high voting rights). Used in combination, these techniques make it possible for corporate insiders to control corporate assets worth considerably more than their nominal ownership rights, or, in the case of managers, their nominal remuneration, would justify.

Corporate insiders’ use of techniques to defend or enlarge their share of power vis-à-vis rivals also tends to reduce or eliminate the need to seek alternative means to access outside finance, notably through better corporate governance. These techniques offer dominant shareholder-managers, prevalent in much of the developing world, an added advantage from their perspective. Rather than having to dilute their control, as would occur with the sale of equity to raise funds from outside investors, they actually increase it, sometimes considerably, beyond their nominal ownership rights.

Unfortunately, these techniques also create strong incentives for corporate insiders to pursue abusive self-dealing and related activities with the sizable corporate resources they control. Not only do such activities constitute severe market distortions, but they lead corporations to behave in ways that significantly increase both rigidities and volatility in the local economy. In economies that lack abundant capital, they create strong incentives for corporations to invest heavily in capital-intensive facilities, which often remain underused. They provide incentives for corporate insiders to pursue strategic rivalry among themselves that costs society dearly in wasted resources and foregone opportunities for needed change.

Corporate insiders’ widespread use of pyramidal ownership structures, cross-shareholdings, and multiple share classes thus goes far in explaining their tendency to resist pressures to improve corporate governance in many developing countries. It also goes far in explaining the severe waste, market distortions, and often massive misallocation of human and material resources associated

with corruption and crony capitalism in too many of those countries.

WHAT TO DO?

The challenge for many developing countries is to break out of this vicious circle. Doing so requires better understanding of the importance of corporate governance for developing countries today.

The OECD has been working to increase this understanding through its Development Center’s research and informal policy dialogue on corporate governance and through its regional policy dialogue programs in Asia, Latin America, Southeast Europe, Eurasia, the Middle East and North Africa, Russia, and China. By bringing together public sector decision makers, regulators, companies, investors, and other stakeholders in each region, these roundtables help build coalitions for reform. Policy discussions have revolved around the OECD’s Principles of Corporate Governance, with each region developing recommendations adapted to local conditions, issued in the form of regional white papers.

High on the list of priorities for reform in many developing countries must be enhancing the capacity to address the problem of insiders’ abusive use of multiple share classes, cross-shareholding, and pyramidal corporate control structures. In many countries, this will require significantly greater public disclosure of share ownership and stronger measures to ensure basic property rights of ownership for domestic and foreign minority shareholders.

The key challenge in many countries today is not so much how to design better corporate governance laws and regulations—many now have good ones on the books—but how to enforce them effectively. Many developing countries have too much and sometimes conflicting regulation that proves to be too difficult to enforce.

Adequate enforcement, which is at the heart of the challenge of moving from relationship- to rules-based systems of corporate governance, raises the issues of voluntary versus mandatory approaches and of the need for strengthened regulatory and judicial institutions to enforce them.

ENFORCEMENT CONSIDERATIONS

Many OECD countries favor an approach to regulation and enforcement that combines relatively high disclosure standards with considerable reliance on voluntary governance mechanisms. Debate is ongoing in

OECD countries as to an appropriate balance between regulatory and voluntary initiatives. For developing countries, further questions can be raised as to the effectiveness of voluntary mechanisms, given these countries' relatively weak institutions of rules-based governance and weak third-party monitoring capabilities. The large information gap from which corporate insiders benefit at the expense of public shareholders, especially in countries with concentrated ownership structures and poor protection of minority shareholders' rights, means that governments will continue to have a central role to play.

The role of regulatory and judicial institutions in public enforcement is particularly important for developing countries. Recent experience highlights the potential value for these countries of having a strong and politically independent, yet fully accountable, securities regulatory commission that is well funded and endowed with adequate investigative and regulatory powers. True for all countries, this experience is especially relevant for countries that have weak judicial systems, not least because of the considerable time it can take to strengthen a country's judiciary system.

Policymakers should not, however, perceive the choice between regulatory and judicial means of enforcement as an either/or choice; they should see those means as complementary and mutually reinforcing. From a long-term development perspective, few institutions are more important for sound rules-based governance and long-term growth in a country than a well-functioning judiciary. This is true not only because a country's corporate governance system comprises considerably more than its securities laws and their enforcement, including credible contract enforcement, but also because of the danger that those with responsibility to regulate, such as a securities commission, may be corrupted or unduly influenced by those whose actions they are intended to

monitor and regulate. It is in countries most burdened by the behavior of powerful distributional coalitions, whose entrenchment is often reflected in a lack of national judiciary independence and accountability, that the risk of corruption or excessive influence tends to be greatest.

Developing a competent, politically independent, and well-funded judiciary is vitally important for enhancing the contribution of corporate governance to corporate performance and long-term national development.

The strong resistance to many of the changes needed to enhance corporate governance often asserts itself through relationship-based systems of public governance. The relative weakening or collapse of those systems in many countries in recent years may constitute a window of opportunity for countries to overcome resistance to changes that are needed as much in their systems of public governance as in those of corporate governance.

The broader point is not only that sound corporate governance requires sound public governance, but also that sound government today requires sound corporate governance. Given the power of corporate insiders and their close relationships with those who exercise political power at the highest levels, development requires simultaneous movement in the institutions of corporate and public governance from the rule of persons to the rule of law. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

CREATING A SUSTAINABLE CORPORATE ENVIRONMENT

John Sullivan and Georgia Sambunaris



The U.S. Agency for International Development (USAID), working with the Center for International Private Enterprise (CIPE), a private sector partner, has been helping countries establish the foundation for ethically managed businesses and to improve the transparency of existing corporate structures. Combining international expertise with local knowledge, USAID and CIPE have guided market participants through corporate governance development and facilitated local solutions based on international principles.

Photo above: A conference on the Asian financial crisis sponsored by the Center for International Private Enterprise (CIPE), which promotes democratic and market-oriented reform by working directly with the private sector in developing and emerging markets. (Courtesy of CIPE.)

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Corporate governance is becoming increasingly central to global development strategies. The spread of market principles to previously closed economies has spawned a new generation of entrepreneurs and investors worldwide, as well as new responsibilities for the U.S. Agency for International Development. If countries are to successfully use the private sector as an engine of economic growth, they need to create environments that nurture competitive, profitable, and ethically managed businesses.

Shortly after the call for rapid economic decentralization in countries such as Russia and Ukraine, as well as all of Central and Eastern Europe, USAID partnered with the Center for International Private Enterprise (CIPE) on issues of corporate governance. An affiliate of the U.S. Chamber of Commerce, CIPE promotes democratic and market-oriented economic reform by working directly with the private sector in developing and emerging markets. CIPE's institutional approach to corporate governance has been to combine international expertise with local knowledge to build mechanisms to improve self-governance in firms.

Although the practice of good corporate governance was once seen as the exclusive domain of companies in the advanced industrialized economies, today the value of corporate governance for the functioning

of markets has been recognized by U.S. government agencies and international and nongovernmental organizations (NGOs). The Organization for Economic Cooperation and Development (OECD) is another leader in international standard setting, comprising 30 member countries sharing a commitment to democratic government and market economies. The OECD has active relationships with some 70 nonmember countries, NGOs, and civil society, and it has a global agenda that includes corporate governance principles. The fact that the OECD just endorsed a new set of corporate principles in 2004 is proof that corporate transparency is an issue for corporate sustainability.

CORPORATE GOVERNANCE IN TRANSITION ECONOMIES

USAID technical assistance programs in corporate governance are rooted in the transformation of the former Soviet Union and countries of Central and Eastern Europe from centralized communist economies to a system of decentralized ownership. The collapse of communism in Europe at the end of the 1980s set off a wave of privatization efforts designed to transfer ownership of state-owned industries from the government to the general population. Although the emphasis of this process fell on the question of ownership, the long-term issue of governance required the establishment of new rules and the education of local stakeholders—stockholders, new company directors, management, and the general public—in order for privatization to contribute to a healthy economy. Values of transparency, responsibility, accountability, and fairness in the governance of companies had to replace old practices of cronyism, favoritism, and backdoor deals. In systems known for weak enforcement, the priority of effective self-regulation became paramount.

With the stability of the new democratic regimes riding on their ability to deliver economic results, USAID renewed its support of corporate governance development as part of its economic assistance programs in Central and Eastern Europe and the former Soviet Union.

MEETING GLOBAL CHALLENGES

USAID is prepared to scale up corporate governance activities in both emerging-market economies and developing countries worldwide. New development challenges related to global competitiveness, the Group of Eight (G8) business climate initiative, and

trade promotion all stand to benefit from high ethical standards of financial reporting and fiduciary oversight of shareholder rights.

CIPE's and USAID's joint approach to corporate governance reform recognizes that each region has unique problems. Many African countries have delayed important economic reforms to address political crises and have tackled corporate governance only in the past 10 years. Public awareness of the issues and the need to develop trust between the public and private sectors are still formidable challenges for any corporate governance initiative in Africa. In the future we hope to move from dialogue to actionable programs of corporate governance throughout Africa.

In Latin America, a focus on enforcement and family-run businesses is a key element of corporate governance programs. There, a strong entrepreneurial class and small- and medium-enterprise structure often limit any USAID role to coordination. In Latin America, policy makers exhibit a hands-on approach to corporate governance that enables assistance programs to focus largely on public awareness and outreach.

Building support for democratic transitions in the Middle East is multifaceted, and corporate governance can play a key role in separating the state from the private sector. Greater awareness of corporate governance and its role in helping countries attract investment and gain competitiveness is evident in many countries in the region.

In Asia, commercial reform and business development often absorb the bulk of scarce USAID resources. In India, which leads in this area, local efforts to improve corporate governance following the financial crisis of 1997 have also been successful in delivering solutions, as evidenced by the work of the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), which is working with lending institutions to educate them on how corporate governance practices—or the lack thereof—affect credit risk.

For the Europe and Eurasia region, CIPE and USAID have sought to shift responsibility for companies from the state to the entrepreneurial class and, where no entrepreneurial class exists, to create public awareness and investors' associations to represent stakeholder interests.

BENEFITS EMERGE, BUT GRADUALLY

Despite the importance of corporate governance practices to financial market stability, investment promotion, competitiveness, and the economic growth of

COMING TO THE MARKET: THE RUSSIAN INSTITUTE OF DIRECTORS

Following the collapse of the Russian banking sector in 1998, Russian companies faced a new business reality: The days of “Wild East capitalism” were drawing to a close. The fragility of Russia’s investment environment would no longer tolerate the shareholder abuse and asset stripping that characterized Russian corporate behavior throughout the first half of the 1990s. Publicly traded Russian stocks were vastly undervalued, and majority shareholders had the necessary market impetus to improve governance and performance.

Seeking to improve investor confidence and boost share values, leading members of Russia’s business community publicly committed themselves to higher standards of corporate governance. A voluntary code of corporate governance was created with the assistance of the European Bank for Reconstruction and Development; a USAID/CIPE grant supported the establishment of the new Russian Institute of Directors (RID).

The RID grew out of a CIPE grant to the Institute for Stock Market and Management (ISMM) to conduct corporate governance training for Russian senior managers and corporate directors. The initial training modules were well received by the business community. Firms quickly saw the value of creating an independent group that would provide ongoing training to companies and their boards, as well as assist in better defining accepted corporate governance standards and practices. Built through the joint sponsorship of leading Russian companies (which serve as its members), the Russian Federal Securities Commission, and USAID/CIPE, the RID has evolved into a full-service directors institute.

Today, the RID offers a variety of corporate governance services to its members, including training for directors and company secretaries, maintenance of a data bank of qualified directors, and stewardship of a new public-private initiative on improving corporate governance.

emerging markets, the benefits of corporate governance are realized gradually. In Russia and Ukraine, 10 years of USAID project activities in institutional development; training of company managers, employees, and policy makers; and technical assistance have resulted in concrete actions by financial market institutions and policy makers to harmonize domestic practices with global accounting, banking, and capital market standards.

The latest generation of development activities in such areas as competitiveness, pension reform, trade, poverty reduction, and anti-corruption practices requires corporate governance assistance to ensure that enterprises act responsibly in their quest for profits. The presence of large informal sectors in the developing world also makes the application of corporate governance practices difficult. Thus, USAID’s development experience indicates that no single development sector should be pursued in isolation. Rather, corporate governance is one of many forms of assistance that seek to cross-fertilize and make the best use of resources for economic growth and poverty reduction.

THE FIVE STAGES OF LOCAL INITIATIVE

The experience of USAID and CIPE has demonstrated that business communities pass through five stages in the adoption of stronger corporate governance practices.

- **Raising Awareness:** One of the challenges that CIPE and USAID have faced in several countries, notably in the Middle East, is that the concept of corporate governance did not exist in the local language. Therefore, discussions first focused on defining the term and trying to apply it to the local context.

Initial efforts also focused on getting the business community and governments to realize the benefits of corporate governance. ADFIAP began its efforts to raise corporate governance practices among its own member banks. It is now working with its members to educate them on how the corporate governance practices of companies should be assessed when making loan decisions because they directly contribute to credit risk. Consequently, many Asian companies are now becoming aware of how corporate governance factors into their bottom line.

- **Developing National Codes:** Once awareness rises in a country’s business community, the process of identifying local business norms that pose compliance issues can begin. Often, the development of national codes begins with the OECD Principles of Corporate Governance as a foundation. Building upon such a foundation, countries can develop their own codes that address the local realities of doing business and adhere to international standards by bringing together champion reformers from host countries representing nongovernmental organizations,

CREATING THE LANGUAGE OF REFORM: THE EGYPTIAN CENTER FOR ECONOMIC STUDIES

As early as 1999, Egyptian private sector leaders were aware of the need to address corporate governance as a key to the modernization of Egyptian firms. With support from CIPE, the Egyptian Center for Economic Studies (ECES) and the Federation of Egyptian Industries introduced the concept to the Arab world, building the vocabulary of corporate governance and promoting its acceptance.

For several years, ECES had conducted a series of studies on corporate governance in Egypt. In 2001, with support from CIPE, the Egyptian Capital Market Association (ECMA) and the Cairo and Alexandria Stock Exchange intensified the debate over corporate governance, holding a major conference for more than 500 of Egypt's market practitioners. Conference participants, including Egypt's minister of foreign trade, Youssef Boutros-Ghali, observed that corporate governance as a concept was new to the Arab world and called for its "Arabization" (<http://www.cipe.org/publications/fs/articles/article2728.htm>).

With CIPE support, ECES, in cooperation with Egypt's main business and finance associations, convened a workshop series explaining key corporate governance concepts and how international trends affect the Egyptian business community. The workshops ignited a wide-ranging debate within the media and the business community. Prompted by Minister Boutros-Ghali, the Arab Linguists Council declared "al-hawkma ash-sharikatiya" as the most appropriate Arabic term for corporate governance.

In 2002, CIPE supported ECES's business-level survey of the corporate governance environment in Egypt. The survey was unveiled at a conference calling for the development of an institute of directors in Egypt to speed corporate governance reform and train the business community on current practice and principles. Today, the Egyptian Institute of Directors, with a board representing mostly private sector associations, is developing a comprehensive training program for board members.

corporate governance institutes, academia, the media, and businesses.

In the Middle East and North Africa, supported by the Middle East Partnership Initiative (MEPI), CIPE is working with groups to develop their own standards—standards that reflect the realities of economic dominance of state-owned enterprises, the prevalence of family firms, and a unique banking system.

Russia put its corporate governance law in place several years ago after private sector groups identified a common set of standards and took them to the government. Russia is now focused on the later stages of corporate governance implementation—compliance and training.

• **Monitoring Implementation:** Once a national code of corporate governance is formally adopted, company adherence must be clarified.

In the West, stock markets have traditionally been the gatekeepers of corporate governance through listing requirements. That approach is often insufficient outside the western industrialized economies. Elsewhere, stock exchanges, where they exist, do not encompass a significant share of economic activities. Parallel to the development of stock markets is the development

of government institutions to monitor the securities industry.

Business associations can play an important role in policing their own members. Those outside the business community also have a stake in the benefits of corporate governance, and so other groups must also become involved in monitoring the process. The press also has a watchdog responsibility.

• **Training for New Responsibilities:** Once a framework for corporate governance has been established, new responsibilities fall to business executives, corporate directors, corporate secretaries, and the like. The business community must educate these players on their roles.

For example, after the passage of Russia's corporate governance law, the Russian Institute of Directors (RID) conducted an extensive series of training sessions across the country for corporate officers. This required the development of original course materials, as well as translations of suitable material from other countries, and it involved the challenge of imparting not just information but also a sense of responsibility and a new code of ethics.

• **Institutionalizing Corporate Governance:** The final stage of a nation's corporate governance development

IMPROVING COMPETITIVENESS: CONFECÁMARAS IN COLOMBIA

Knowledge about best practices in corporate governance is often limited in developing countries. In Latin America, this lack of awareness holds countries back from being truly competitive globally or being able to take full advantage of free trade initiatives that are being negotiated throughout the region. CIPE began working with the Colombian Confederation of Chambers of Commerce (Confecámaras) in 2002 to strengthen corporate governance, with the aim of increasing investor confidence in the country and building stronger capital markets.

Confecámaras launched its corporate governance program with a survey of current practices and knowledge of best practices within the private sector. The results were published in a leading business magazine, *Dinero*, instantly raising public awareness of how much needed to be done for Colombia to catch up to international standards. The program then established a three-pronged strategy: developing a national standard for best practices within the private sector, advocating for changes in laws and regulations to improve corporate governance, and training journalists to effectively report on the process.

Confecámaras participated in OECD roundtable discussions within the region to establish a regional standard of best practices, while simultaneously working with the Colombian business community through a series of white papers and public forums. The result has been a measurable increase in the number of companies seeking out advice and applying these new standards to their business operations. CIPE and Confecámaras are using the success of this program to generate interest in strengthening corporate governance in the private sectors of neighboring countries.

The Confecámaras press training program recognizes the important watchdog responsibility of the media. The complexities of corporate governance make it a difficult subject to report on, even before considering the difficulty in obtaining reliable information. The Confecámaras program thus provides specialized training for journalists on how to report knowledgeably on economic issues in general and corporate governance in particular.

comes when the business community accepts it as a normal and beneficial part of doing business and when the institutions that support compliance are solidly in place. Those institutions include private sector initiatives such as national institutes of directors to provide ongoing professional enrichment, as well as governmental institutions such as a judicial system that adjudicates conflicts fairly.

In Russia, USAID supported the creation of RID under the direction of Igor Belikov, a leader in the mobilization of the Russian business sector to develop its corporate governance law. Similarly, an Institute of Directors in Turkey has made a good start.

LOOKING AHEAD

The link between corporate governance and economic development is likely to become stronger as governments and businesses deal with the fallout from the Enron, WorldCom, and Parmalat scandals. Although corporate governance reform is costly for both domestic and international firms, it ensures sustainability in the long run and opens the door to the economic growth necessary for eradicating poverty. Moreover, a healthy business climate reduces risk and enables countries to join groups such as the World Trade Organization and the European

Union. Alternatively, corporate governance may result in higher investment ratings.

USAID and CIPE are designing corporate governance activities to address the broader spectrum of corporate governance issues. Such activities are necessary to long-term corporate viability, profitability, and sustainability in developing countries. Corporate governance also is a first step in building the capacity of the private sector for leadership not only in economic matters, but also in social and political development. The process used by USAID and CIPE imparts consensus-building, communications, and advocacy skills that the business community can employ elsewhere. As companies face increasingly frequent calls for “corporate social responsibility,” the more sustainable alternative is a pattern of corporate citizenship in which the private sector proactively works to find solutions to common problems.

While it is true that companies may need to cut costs to raise their global competitiveness, investment in corporate governance is proving to be the necessary foundation for businesses that inspire confidence among investors, employees, and managers, and for practices that lead to sustained economic growth. ■

TRAINING MANAGERS FOR THE FUTURE

Mary C. Gentile



Managers can be educated to devise business practices that balance ethical and economic realities. But training programs will succeed in influencing actual behavior only if they address the purpose, the social context, and the overall impact of any given business plan. Although business educators around the globe frame questions of values and corporate responsibility in a variety of ways, there is ample common ground for teaching ethical management across national borders.

Photo above: Kenneth Sparks of the Center for International Private Enterprise speaks on building effective and transparent boards of directors. (Courtesy of CIPE.)

Mary C. Gentile is an independent business consultant and former faculty member, researcher, and administrator at the Harvard Business School.

Following a series of corporate scandals involving Enron, Tyco International Ltd., WorldCom Inc., Arthur Andersen LLP, and other companies, business educators in the United States once again face questions about their ability to prepare managers to lead organizations responsibly and ethically. Educators have been here before. There were insider trading scandals in the 1980s, and defense industry scandals before that. In fact, the question of ethics and values has been central to the espoused purpose of formal business schools in the United States since their origins in the early 20th century.

A GLOBAL CONCERN

The challenge to business leaders to broaden their perceptions of corporate responsibility is not, however, limited to the United States, nor is it restricted to the narrowly framed subject of business ethics. In 2004, the Association to Advance Collegiate Schools of Business, the international accrediting body for business schools, issued new guidelines for the integration of ethics and governance into global management education. The guidelines focus on four areas: the responsibility of

business in society, ethical leadership, ethical decision making, and corporate governance.

Similarly, the European Union's discussion paper titled "Promoting a European Framework for Corporate Social Responsibility" (2001) helped trigger a multicountry review of the state of business research and teaching, as well as the development of research and curriculum initiatives organized under the sponsorship of the European Academy of Business in Society.

The U.N. Global Compact—an initiative that has brought together more than 2,000 businesses worldwide with United Nations agencies, labor, and civil society to advance responsible corporate citizenship—has worked through its Learning Forum to build networks of business educators across the globe. The forum has allowed educators to share research and to develop case studies to illustrate the practices of companies that strive to adhere to the compact's principles on labor, the environment, human rights, and the fight against corruption.

The U.S.-based Aspen Institute's Business and Society Program has launched a global consortium of 11 business schools in India, South Africa, Spain, Mexico, Canada, and the United States, all working in different ways to address issues of ethics, corporate social responsibility, corporate citizenship, sustainability, and good governance.

ACHIEVING A BALANCE

With all the attention paid to business ethics and corporate responsibility, why do business educators find themselves facing calls for an even greater focus on values and responsibility every few years? Is this just a cyclical issue destined to surface every time misbehavior rises to an unacceptable level, and then wane once the crisis is past? Or is the problem that educators' efforts have been unsuccessful thus far?

There will always be those who will push the limits of behavior too far. But the problem becomes critical when violations are the norm rather than the exception, placing business behavior out of alignment with societal needs and expectations. Such a misalignment makes it especially difficult for business schools to train students to manage ethically and still compete effectively in the real world.

Too often in the past, the teaching of business ethics focused more on the traditions of moral philosophy and not enough on the practical tools of business analysis. Curricula pitted business objectives against moral objectives instead of working to reveal the interdependence of the two. Much discussion was spent on whether to take a particular course of action that

might be unethical rather than on how to apply one's values to business decisions. This, in turn, raises another question: In a world of unsatisfactory norms, how do we prepare managers to devise alternatives that balance ethical and economic realities?

VALUES-DRIVEN ACTION

If a discussion of business ethics and corporate responsibility is to succeed in influencing behavior, it must address tangible and pragmatic questions of business purpose, business context, and business metrics. These questions include the following:

- **Purpose:** What is the purpose—in societal and business terms—of a business or business activity? Management scholar Charles Handy argued in the *Harvard Business Review* (December 2002) that "the purpose of business is not to make a profit, full stop. It is to make a profit so that the business can do something more or better." A related question is whether this concept can reconcile the norms, economic realities, and levels of development of one country with another.
- **Social Context:** Are the legitimate rights and responsibilities of multiple stakeholders considered? Is a proposed strategy evaluated not only in terms of predicted business outcomes, but also in terms of its broader impacts, for example, on quality of life, the wider economy of a region, and security and safety? Are impacts on employees, pensioners, local populations, and natural resources factored into the profit-making equation?
- **Metrics:** How are performance and profitability measured? What is being counted and, more importantly, what is not being counted? Are impacts and results measured across both short- and long-term time frames? How do we compute the effects of what we tend to call externalities, such as the depletion of nonrenewable natural resources or the social disruption of communities caused by large-scale business relocation?

All of these questions should be examined in the context of empowering the individual manager to engage in values-driven action.

Often, in a world of global business, we hear that values and corporate responsibility cannot be taught

because they have cultural determinants that preclude an effective and shared approach. But experience differs. Increasingly, when educators approach business challenges with an awareness of questions of purpose, context, and metrics as described above, they find that there is ample common ground for teaching across national borders. The illustrations and the mechanisms for implementation may differ—for example, in India the case studies may feature more family business enterprises, and in China they may feature more state-owned enterprises—but the objectives centered around quality of life, security, and economic opportunity are shared.

DIFFERENT APPROACHES

Currently, business educators around the world are framing questions of values, ethics, and corporate responsibility in a variety of ways. For example, concern about finite natural resources and environmental damage caused by industrial activity is fueling research and teaching initiatives on sustainability.

The U.N. Global Compact partnered with Sabanci Universitesi (Istanbul) and the Wharton School of the University of Pennsylvania in 2004 to offer a two-part conference, “Bridging the Gap: Sustainable Environment,” and attracted faculty and business practitioners from around the world.

EGADE-ITESM, the internationally recognized graduate school of business at Monterrey Tech in Mexico, is designing a new master of business administration (MBA) concentration on sustainable development and technology management to support the creation of new sustainable businesses. The program will be organized around project learning experiences and will engage research from a network of research centers throughout Mexico.

The Johnson Graduate School of Management at Cornell University has developed a Center for Sustainable Global Enterprise that houses a chaired professorship and provides the focus for cross-disciplinary research,

curriculum development, and corporate and nonprofit partnerships.

Many business schools around the world are also taking advantage of their specific regional concerns and traditions to prepare future business leaders to manage both effectively and ethically.

For example, S.P. Jain Institute of Management and Research in Mumbai, India, has developed several initiatives including the Center for Development of Corporate Citizenship, which provides nonclassroom experiences to sensitize students to the social impacts of management. Over the past decade, this center has undertaken more than 800 projects involving more

than 50 firms and 100 nongovernmental organizations (NGOs). Their Gita Shibhir is a two-day residential workshop, held at an ashram (institution for spiritual study), which exposes students to the spiritual aspects of life and self-management based in the traditions of Indian scriptures.

The Asian Institute of Management in Manila has pioneered a master’s degree in development management specifically designed to prepare leaders who will work in emerging economies to deal with the particular challenges and opportunities found there.

The University of Stellenbosch Business School in South Africa is developing a doctorate program in leadership, governance, and ethics designed to align with the goals of the New Economic Partnership for Africa’s Development.

There also are numerous networks such as the European Business Ethics Network, which includes members from 33 countries who work to forge connections between academics and business practitioners and to promote ethics in education, training, and organizational practices.

The heightened commitment to values and responsibility in the training of business leaders is not restricted to one country or one theoretical tradition. The issues that increasingly need to be taught can be organized around questions of purpose, social context, and metrics; the tools and approaches required to address these issues include social psychology, anthropology,



“Even a small kingdom, Your Highness, can make effective use of modern management techniques.”

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global spiritual traditions, political history, negotiations, public policy, and so on.

What is shared is a growing recognition that the challenges of one region rapidly become the challenges of the world, and that business norms cannot long remain at odds with the needs and expectations of a wider society.

THE ROLE OF EDUCATORS

Educators can provide the context and perspective to help managers re-frame conflicts as shared challenges rather than opposing values. They can provide examples of similar conflicts that were resolved in the past. They can teach managers to communicate across apparent differences to find common concerns and solutions. Perhaps most importantly, they can reinforce the fact that business norms do not have to be in conflict with wider societal expectations, that, in fact, they cannot long remain so.

If the social impacts of business are framed only as ethical questions, one may persuasively argue that business education comes too late to change the behavior of students. Similarly, faculty trained in economics or psychology or management may object that they lack a formal grounding in philosophy and therefore cannot talk about values in the classroom. Moreover, the debate in the United States has often stalled over the question of whether ethics should be taught as a stand-alone course or integrated into such other business areas as marketing, finance, and accounting.

On the other hand, when ethics questions are framed as matters of creative problem solving, the role of education is clearly essential. Students can then be offered tools, analytic methods, context, and skill-building exercises, rather than preaching.

Curriculum design increasingly reflects the reality that there is a need for courses devoted exclusively to subjects like values and decision making, sustainable management, and the role of business in society, as well as for values-based discussions integrated into the functional areas where difficult questions are likely to surface.

Marketing courses are best equipped to address the social impacts of niche marketing, for example, or cause-related marketing. Accounting courses are the most appropriate places to consider the likely effects of different accounting approaches on the quality of information they produce and the managerial incentives they tend to trigger.

When framed as questions of business purpose, social context, and metrics, ethics and governance are indeed among the most important lessons that future managers need to learn. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

THE CASE FOR POWERFUL SHAREHOLDERS

Robert A.G. Monks



Governments should affirm that creating an effective shareholder presence in all companies is in the national interest and that it is the nation's policy to aid effective shareholder involvement in the governance of publicly owned corporations.

Photo above: A shareholder asks questions during the Level 3 Communications, Inc., annual shareholders' meeting in Omaha, Nebraska, in 2003. Such meetings provide a forum for investors to air their concerns. (©AP/WWP Photo/Nati Harnik)

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In the United States for nearly 80 years, lawyers and jurists, in particular former Supreme Court Justice Louis D. Brandeis, have taken the lead in expressing concern about the widening separation between shareholders and corporate management and the resulting abuse of corporate power. The same concerns were expressed by Adolph Berle and Gardiner Means in 1932 in their book *The Modern Corporation and Private Property*. The prescient concerns of all these pioneers were well summarized in 1970 by legal scholar James Willard Hurst:

Stockholder surveillance is the principal internal factor on which tradition relied to legitimate corporate power. ... The continued willingness of our citizens to have privately chosen corporate leaders make decisions affecting production, employment, and quality of life has been countenanced because of the accountability of these leaders to the corporate owners. In our view, the practical erosion of stockholders' voting power undermines the very structure

of private enterprise upon which our national economy and political life rests.

CEDING POWER TO INVESTMENT INSTITUTIONS

Corporate shareholders have involuntarily, indeed largely unconsciously, relinquished powers to corporate managements. This trend follows from the marked rise of tax-incentivised institutional investment, and it has left an ownership vacuum at the heart of shareholder capitalism. Hence the resultant abuse of managerial powers and, inevitably, a backlash against business.

Investment institutions, lacking the ability to control corporate managements, fall back on the strategy of holding a wide spread of shares combined with a high share turnover. Shares are regarded like betting slips on unforecastable races. Thus, shareholders have long been “punters,” or gamblers, rather than “proprietors.”

The essence of any system of governance is that those to whom major powers are entrusted must be accountable to those whom they serve; otherwise, self-interest will prevail to a greater or lesser degree.

American shareholder capitalism fails this test. The accountability that exists is typically limited and delayed. Managements are not effectively accountable either to individual shareholders or to the investment institutions and fund managers that are the intermediary agents of the ultimate shareholders. Nor, in turn, are these intermediaries effectively accountable to the ultimate shareholders—the individuals who are pension fund members, and policyholders. There is thus a double accountability deficit, which inevitably results from passive, absentee ownership. This is the fundamental weakness of shareholder capitalism, and it must be effectively remedied for all other weaknesses to be resolved.

It is a basic tenet of free market capitalism that the system rests on the effective ownership of private property, that is, that owners choose how their assets are used to best advantage. It is thus particularly

unsatisfactory that the largest single category of personal property—stocks and shares (including the beneficial interest in stocks and shares held collectively via investment institutions, mainly to provide retirement income)—should lack effective ownership. Those who hold shares directly—in America, 50 percent of all shares are held directly—are individually so insignificant as to be virtually powerless. Those who own shares beneficially are even more powerless. (A beneficial owner is one who enjoys the benefits of owning a security or property, regardless of whose name the title is in.) Only if shareholders can unite effectively—and in practice this applies only to institutional shareholders—will corporate managements be held accountable. This seldom happens save in a rare corporate crisis, by which time the damage has been done.

PASSIVE PENSION FUNDS

In America, the tradition of individual investment remains strong, with half of all shares owned personally. Most of the rest are owned by life insurance companies, mutual funds, and direct benefit pension funds, whereby companies invest to provide staff with pensions. Under

powerful tax incentives introduced in 1970—the 401(k) plan, a retirement savings plan funded by employee contributions and often matching contributions from the employer—employers are switching to direct contribution schemes. An American employer’s contribution can be and frequently is paid in the form of its own shares. For example, many employees at Enron held more than 50 percent of their retirement funds in their own company’s shares. In many mega companies, such as General Electric and Coca-Cola, the proportion is 75 percent, and in Proctor & Gamble, it is more than 90 percent. While a company is stable and growing, this seems acceptable, but for employees’ jobs and pensions alike to be tied to a rising share price is dangerously risky.

Increasingly, most employee contributions to 401(k) schemes go into a wide spread of shares; sometimes the employer’s contribution does as well. Mutual fund firms compete heavily for this huge business. Their corporate



“This is the part of capitalism I hate.”

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governance activities, if any, will thus have a crucial effect on both the level of pensions and American corporate governance.

There is to date no tradition of corporate pension fund or mutual fund corporate governance activity. The sole occasional exceptions are some of the larger public sector pension funds, which are in no way beholden to corporate managements. (An honorable example is the College Retirement Equity Fund—CREF.) Thus, in America, opposition to very high executive remuneration or the routine repricing of share options is almost unknown, as is regular direct pressure on failing chief executive officers (CEOs) to resign. There is resentment but realistic recognition that shareholders lack the power to do much about it. American CEOs frequently lose their jobs because of short-term performance failures, but this is due to market pressures, not shareholder activism. Whether recent corporate scandals will cause lasting change remains to be seen.

Corporate pension funds, controlled by their corporate managements, have almost never been activist. There is an implicit understanding that each company's pension fund will refrain from an activist stance in return for a reciprocal stance from all other pension funds because corporate managements prefer to discourage any form of corporate governance intervention to their mutual benefit. As for life insurance companies, banks, and mutual funds, they are, respectively, in competition with their peers, and hence cooperative action is comparatively rare. Many are parts of wider groups also seeking banking or insurance business. Many own fund managers and so are additionally wary of antagonizing corporate managements.

There is an explicit duty on all these institutions to be proactive investors on behalf of their beneficial shareholders—indeed, it is trust law in the United States, albeit seldom enforced. But that collective action, which alone could be influential, is rare, and it is largely confined to cases of gross underperformance, usually over many years, or after very serious corporate management misconduct, by which time it is too late.

FUND MANAGERS: CONFLICTS AND SHORT-TERM EXPECTATIONS

The constraints that make the investment institutions largely passive owners apply equally to the individuals known as fund managers. These investment specialists manage the funds of the investment intermediaries—particularly pension funds—few of which are managed

internally. Most mutual funds manage their own funds. More than 75 percent of fund managers are owned broadly equally by investment banks and insurance companies. Most insurance companies usually invest not only their own very large funds (principally of policyholders) but also corporate and public sector pension funds, making them both direct institutional investors and fund managers.

Investment provisions are always agreed with clients, but fund managers have the prime responsibility for choosing the strategy best suited to client needs. They unquestionably exercise great power in determining investment decisions. Top fund managers and specialists are among the highest paid people in America, with salaries at least equal to those of most senior corporate managers. The management of the major pension funds of America's top 500 companies (more than 75 percent of the stock market) is highly concentrated on the top 10 fund managers. They, thus, compete fiercely to attract and retain major corporate business, inevitably reducing their scope for holding corporate managements accountable.

The inability of fund managers to hold corporate managements, who are their main direct or indirect paymasters, accountable inevitably causes them to seek risk diversification by holding very wide spread share portfolios, the reaction of a punter rather than a proprietor. This process, as noted earlier, is compounded by the fact that the managers' clients expect funds to perform well over only relatively short periods. This highlights one of the most significant weaknesses of shareholder capitalism: the serious mismatch between the periods over which fund managers are judged and the rather longer periods, say, five or six years, that would better suit most beneficiaries. Client pressures inevitably cause fund managers to favor shares expected to perform well on a short-term basis, a phenomenon that has caused many commentators to blame fund managers for share bubbles and collapses over the last four years.

BREAKING THE CYCLE

There is a harmful and destructively intensifying process at work here whereby optimal long-term corporate performance is damaged and with it the interests of most investors. Thus, there are few incentives for fund managers to take as long-term a view as their investment skills justify, or corporate managers as their strategic management skills justify. At the same time, fund managements blame corporate managements

fund managements blame corporate managements *collectively* for putting them under undesirable short-term pressures and vice versa. Breaking this vicious circle is one of the most important challenges for corporate governance reform.

Governments should affirm, in support of the fundamental principle that there should be no power without accountability, that creating an effective shareholder presence in all companies is in the national interest and that it is the nation's policy to aid effective shareholder involvement in the governance of publicly owned corporations. A national-level council should

be created to ensure that this policy is applied by all executive and judicial branch agencies, competition authorities, stock exchanges, and other similarly involved entities. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

A BUSINESS PERSPECTIVE ON CORPORATE GOVERNANCE

Interview With Rosemary Kenney and Nancy Nielsen of Pfizer Inc



Businesses that hope to succeed in today's global marketplace must incorporate newer, stricter legal requirements and also take into account growing social expectations. According to one pharmaceutical company that has distinguished itself as a leader in corporate governance, good citizenship and ethical practices eventually produce a stronger bottom line. "Doing business with integrity is good for business," says Nancy Nielsen, Pfizer's senior director of corporate citizenship. She and Rosemary Kenney, the company's senior manager for corporate governance and communications, spoke with the Economic Perspectives editors on Pfizer's perspective.

Photo above: Trachoma examination in Morocco. Pfizer, in conjunction with the World Health Organization, supports a program to combat trachoma, the leading cause of preventable blindness in the developing world. A critical component of the strategy is the use of Pfizer's antibiotic, Zithromax. Patients can take a single-dose oral treatment for trachoma—a radical advance from the previous regime of daily applications of antibiotic eye ointment over a six-week period. (©1997, Pfizer Inc)

Pfizer Inc discovers, develops, manufactures, and markets prescription medicines for human beings and animals. The company has more than 100 plants around the world and its products are available in more than 150 countries.

Question: Following a series of scandals in the U.S. business world, corporate governance became a global buzzword and the U.S. Congress passed the Sarbanes-Oxley Act strengthening corporate governance regulations. Some firms have complained that the pressure to be more transparent and accountable actually shackles them instead of providing guidance. The debate begs the question: Is good corporate behavior good for business? And can you really force it on corporations?

Answer: What most corporations are talking about are the costs associated with complying with new U.S. Securities and Exchange Commission (SEC) rules mandated under Sarbanes-Oxley. And yes, it does cost money to implement internal auditing practices if a company never had them before. Doing so may require additional personnel, additional work—sometimes outsourcing—to determine the best methodology to conform to the new guidelines.

On the other hand, companies like Pfizer already had most of these procedures in place and were already following very high standards of ethical practices for transparency and accountability. We did have to make some minor adjustments to our internal policies and procedures, but the Sarbanes-Oxley rules have not had the same impact on us as on some other companies. And while it has cost us some additional money, Pfizer does not look at Sarbanes-Oxley as a burden because we agree with it.

Q: What about those companies—especially smaller firms—that do find it a struggle? How can they be convinced that it's in their best interest?

A: The bottom line is that if you want to be a publicly traded company, you have to conform to these mandates. I used to work for a much smaller company, but I was still under the same SEC mandates as a larger publicly traded company. Those mandates included paying New York Stock Exchange listing fees and the costs associated with publishing a proxy statement and annual report, mailing it to investors, filing a 10-K report [a comprehensive overview of a company's business and financial condition] with the SEC, and filing SEC forms for the officers and directors of the company. The SEC's role is to protect the shareholder.

If you're a publicly traded company, it's far better to invest in good practices that support accountability and ethical behavior, rather than hoping that the SEC or any other regulatory body never questions you.

Q: So if these practices were already in place, it suggests that your company believed them to be good for business. Is that the case?

A: As a rule, good conduct is good for business, and doing business with integrity is good for business. In the early 1990s, Pfizer became the first company to establish a vice president for corporate governance—an officer-level position—so obviously Pfizer is not new to the idea that high standards of corporate integrity are integral to doing business. And that's basically what Sarbanes-Oxley is trying to do: It's trying to regulate and mandate ethical behavior.

Q: What precipitated Pfizer's decision to create the position of vice president for corporate governance?

A: There were at the time a lot of shareholders questioning some of the decisions being made by Pfizer, and the chairman and CEO [chief executive officer] saw an opportunity to discuss with institutional investors—who were very large shareholders in Pfizer—the issues that Pfizer faced as a pharmaceutical company. They designated a vice president for corporate governance whose mandate was to go out and speak to institutional investors and open a dialogue that would allow for an exchange of ideas from both sides. The goal was for management to better understand the issues that were important to institutional investors and for the investors

to better understand the issues facing the pharmaceutical industry. And that certainly has been a very beneficial relationship.

Q: Many non-U.S. companies don't have a system like Pfizer's. Could you describe how they might implement a similar approach to corporate governance?

A: The approach to corporate governance starts at the top of the corporation. There is no way it can be implemented unless there is "tone at the top." It has to come from the senior management and the board of directors; there has to be an absolute buy-in that corporate governance is good for business.

In practical terms, the good governance message is sent to employees through training manuals and mandatory education. Pfizer employees have to take online governance tests. Employees are made aware of the laws and rules and how they apply to everyday operations.

Pfizer also has a 24-hour hotline that employees can call if they see behavior that might involve wrongdoing. Our compliance department makes presentations at staff meetings for employees in locations all around the country. Employees receive e-mail reminders on a regular basis, and corporate governance posters are regularly on display. At Pfizer there's always some message about compliance with governance and laws and rules. I've worked in a number of different companies, and it's more pronounced here than anywhere I've ever worked.

Q: A major theme of corporate governance today involves the active participation of shareholders in a company's decision making. How do Pfizer shareholders make their concerns known?

A: Shareholders make their opinions known through the time-honored methodology of sending shareholder proposals to the company on an annual basis. Those proposals are usually published in a proxy statement, and they often voice shareholders' discontent with certain issues.

More recently, Pfizer was one of the first companies to provide e-mail addresses for the chairs of each of the committees of the board, as well as for the board of directors as a whole. Some shareholders have taken advantage of that and communicate with directors via e-mail.

But whatever the form of communication, Pfizer's policy is always to answer shareholder questions and keep an open line of communication.

Q: What is the volume of these communications, and from whom do they tend to come? Are they limited to the large institutional investors?

A: We receive e-mails primarily from individual investors. Mail totally unrelated to business—résumés, solicitations, requests for philanthropy—are filtered out and forwarded to the appropriate person for handling. The board gets a quarterly report that lets them know what issues are of importance for the shareholders, and, when appropriate, the board will respond.

Q: How is corporate governance involved in the selection of the Pfizer board of directors?

A: Each director undergoes an annual nomination process conducted by the corporate governance and nominating committee of the board. Each director's attendance, fees, other board affiliations, and so on are reviewed on an annual basis. The board is predominantly an independent board. The only "insider" is our chairman and chief executive officer, Hank McKinnell, and we have what's called an outside related director in our former CEO, Bill Steere (William Steere Jr.). The rest of the board is independent.

Q: Could you describe how Pfizer distinguishes between corporate governance and corporate citizenship?

A: We talk about citizenship as being our role in the local and global community and how we conduct business responsibly. We break that into five different pieces: advancing good health, engaging in dialogue with stakeholders, protecting the environment, conducting business responsibly—that's the governance piece—and respecting employees.

Q: What form does that take, in practical terms?

A: When you construct a value chain, you go through every piece of a business. In pharmaceuticals, the chain would include research, development, manufacturing, sales, marketing, delivery, etc. We have a chart on our Web site that identifies each piece of our value chain, and underneath each we've written what the components are for corporate citizenship.

For example, in research and development (R&D) it would involve the allocation of the R&D budget to developing and developed world diseases. Or it might involve the transparency of clinical trial data. One of the things we've done recently is to post our political action committee contributions [to political candidates] on our Web site. When you add the pieces on the value chain, you get an overall picture of the kinds of things that make for a responsible company locally and globally.

Q: How would you respond to economists who argue that companies should not be used for "social engineering," or that involvement in charitable enterprises can cause a firm to lose focus on its primary purpose of maximizing profits?

A: You asked earlier whether good governance affects profits. And while there is no direct contribution to the bottom line, there is a clear indirect contribution to a company's success.

For a good company to be successful today, it really has to do both. Over the last 10 years, we've seen tremendous changes in society—with globalization, advances in communications, greater awareness of social inequities—and there's been a shift in how society sees the role of business. One reason Pfizer takes on these environmental and social projects is that it helps protect our license to operate. The second reason is that we've looked at what it takes today to create a sustainable business, and we've concluded that it requires being involved in all aspects of the community. So there is an impact on the bottom line, and that's the business case for corporate governance.

Q: Do you have any concrete examples of cases in which your involvement in community or environmental projects has been good for Pfizer as a business?

A: The watershed in the pharmaceutical industry was the summer of 2000, when 39 pharmaceutical companies sued the South African government to prevent it from importing cheaper versions of AIDS drugs. Pfizer was not among those companies, but most experts look back on that as a time when the pharmaceutical industry was out of touch with the expectations of society. And the industry as a whole suffered from the negative public reaction.

We also know that by engaging on the ground, socially and environmentally, we create relationships that we would not have otherwise. It creates a channel

through which we can educate people about the industry. Remember, pharmaceuticals is a high-risk, high-reward field. Ninety-five percent of the attempts in our laboratories fail; only 5 percent turn into medicines that make it to the market. Therefore, the medicines that make it to the market need to cover the costs of all the failures. That's one of the very basic things that we need to communicate to the public.

Being on the ground also gives us an early warning system for upcoming issues. If the industry had been really engaged back in 2000, the pharmaceutical lawsuit against South Africa never would have happened. And if you start spinning out the implications of that lawsuit had it really taken off, it potentially could have led to such a backlash that it would have shut down some pharmaceutical companies' licenses to operate.

Q: What does Pfizer mean when it states that one of its goals is to improve access to health care across the globe?

A: Our primary mission is to discover and develop medicines. We have the largest private laboratory in the world, with 13,000 scientists and 116 plants around the world making medicine. The next piece of it is to make medicines available and, we would say, affordable to people around the world.

Q: How do you go about doing that?

A: We do that largely through public-private partnerships. We partner with governments, nongovernmental organizations (NGOs), civil society organizations, faith-based groups, and patient advocacy groups to help deliver the medicine. We also have multiple channels for medicine donations to hospitals and health care clinics.

In the United States, we've very recently started a program under which people who do not have drug coverage insurance—45 million people in the United States—can qualify for free or discounted Pfizer medicines. The program is outlined on our Web site, and there's a toll-free number that people can call 24 hours a day to find out if they are eligible.

Q: How effective has this been?

A: We introduced it about four months ago, and we've been struck by the amount of marketing necessary to get such a program under way. You would think that if you put information on the Web and sent letters to senior citizens and patient advocacy groups, people would seize



Pfizer partners with governments to donate Diflucan® to treat opportunistic infections associated with HIV/AIDS in developing countries. The company has helped train 18,000 health care providers in 915 dispensing clinics in 23 countries in Africa, Asia, and the Caribbean. (Photo of Helen Joseph Hospital in South Africa © Pfizer Inc)

the opportunity right away, but we've actually had to treat this as a marketing campaign to get people to apply.

Q: Do Pfizer shareholders ever complain about these and other donation programs?

A: We do get complaints sometimes from Pfizer shareholders—they usually send a letter to our chairman—and our response is really the point that I was making earlier: In order to protect our license to operate and to run a sustainable business in today's world, to meet society's expectations of business and society's expectations of pharmaceuticals, this has to be part of our business model now.

There has been a big shift in this country over the past five years. People believe that they should get new medicines at very cheap prices, but somebody needs to pay for innovation.

Q: So how do you reconcile those opposing demands?

A: One of the ways we do it is through these public-private partnerships, like the one I mentioned for drug-coverage help to 45 million Americans. But it's an issue that the entire industry is wrestling with right now.

Q: Do you have partnerships like that overseas?

A: One of my favorites is what we call Global Health Fellows. We have created a medical "peace corps" of skilled Pfizer employees—doctors, epidemiologists, technicians—who go on six-month sabbaticals to developing countries, specifically to work on the ground with NGOs to find and treat infectious diseases, primarily AIDS.

Our longer-term programs include an international initiative to treat trachoma, which is the leading cause of preventable blindness in the world. We have, in conjunction with the World Health Organization (WHO), a program to prevent trachoma that involves donations of our antibiotic Zithromax, environmental help, basic sanitation education, and some surgery. We're going to be able to completely eliminate trachoma by 2020. I think we're in 18 countries.

Another program is the international Diflucan partnership. This is for AIDS-related infections such as thrush. Diflucan helps eliminate thrush almost immediately, and we provide it for free. For the least developed countries that meet a certain WHO income threshold, there is no cap and no time limit on the medicine donations. And we do that through partnerships with the government and NGOs. It's not just us on our own. Everything we're doing nowadays is through partnerships.

Q: What sort of performance measures do you use in deciding which programs receive funding?

A: The ultimate performance measure is healthy people, or people who don't get sicker—for example, the number of people cured of thrush, or the number of people who either regained their vision or were prevented from going blind. It all comes down to people and health. That's the bottom line.

One of things we're looking for is unmet medical needs and to see what we can do there. That's a big area that has been neglected, and we're prepared to take that on. We're not going to make any money from it; it's part of being a good corporate citizen.

Our 2003 annual report opens with this phrase: "We will define success as something broader than performance in the marketplace."

Q: Do you find that you are at the forefront of a movement involving other businesses?

A: It's not limited to us. But because Pfizer is the third- or fourth-largest company in the world by market capitalization, and because we're in health care, which affects everybody and is tied to everyone's economy, I think that what we do has a big impact and therefore it's really important that we do it.

I also think there is a trend among industry leaders. I know that my counterparts at Microsoft, Hewlett-Packard, Coca-Cola, DuPont, are all moving in the same direction. ■

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GOVERNING FAMILY BUSINESSES

John L. Ward

Corporate governance of family businesses differs fundamentally from that of widely held public companies. Family ownership concentrates control and facilitates decision making, which can both lower governance costs and permit unconventional but strategically advantageous decisions.

A well-functioning system helps build trust within the family, and a good family dynamic, in turn, becomes an asset to the business because it enables each separate piece of governance to function better and add more value while remaining aligned with the other components of the governance system. These governance advantages can provide clear economic benefits.

However, a growing business becomes increasingly complex and creates its own demands for a more formal organizational structure. Family business managers must adapt their governance practices accordingly. Indeed, success drives the need to adapt and change—and all family businesses eventually face this reality.

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FAMILY BUSINESSES: PROS AND CONS

With ownership controlled by one or a few people from a family, family firms have competitive advantages and disadvantages over publicly held companies. On the plus side, controlling ownership can take the long-term view. Patient, consistent investments can yield excellent future benefits. Investments in corporate culture can also yield benefits that firms that are run for short-term stock market results do not have the time to reap. And companies controlled by a small group of hands-on owners can pursue contrarian strategies and reject mediocre conventional wisdom.

On the other hand, firms controlled by a few can be isolated and insulated from market realities. Seeking personal comfort and forsaking external accountability can lead to stale strategy, no succession planning, and organizational stagnation. And unchecked quarrels among family owners can be catastrophic to a company.

The difference between a family firm that succumbs to its weaknesses and one that exploits its relative strengths lies in the quality of the governance system. Successful family firms appreciate the power of their ownership control, volunteer for the accountability of an independent board, and take care to properly define the roles and responsibilities of ownership, management, and the board of directors.

The essence of the family business difference is that the nature of ownership is different. Successful family firms also understand how governance practices need to evolve to reflect the changes in the business and within the family.

THE NATURE OF FAMILY OWNERSHIP

Family ownership groups not only concentrate control but also often have a strong emotional attachment to their businesses. A family can have a sense of moral obligation to other stakeholders, or even view their business as a vehicle for making a positive contribution to society. Moreover, family owners sometimes see the

business as a social legacy built by past generations, and one that should continue in succeeding generations.

The lack of readily available liquidity is another important difference between public and family ownership. Relinquishing ownership of family companies is often difficult. Some families create legal restrictions on the sale of stock, and many family businesses are privately held. In these circumstances, creating a market for the sale of stock can be complex. Tax policy can also come into play, making the sale of stock in the family business costlier than continued ownership.

Owning stock in a family company tends to concentrate the wealth of individuals in a single asset. In family ownership groups, a disproportionate percentage of the net worth of many individuals is often tied up in the family business. This means that family business owners, as a group of investors, have less diversification and higher risk than they would as investors in the broader stock market. Such concentrated risk makes family business owners more attentive to their investment and tends to keep them more active and engaged. And this, in turn, makes families more committed to fixing what is wrong with their businesses, rather than fleeing them economically. At times, concern for the family's reputation can seem as important as safeguarding the collective family business investment.

BUSINESS GOVERNANCE IN PUBLIC COMPANIES

Governance in the public market is built on a paradigm that relates directly to the nature of widely held ownership. Owners of shares in a public company can "vote with their feet" by selling their shares when performance is below expectations. The individual shareholders of such companies have little recourse to influence the decisions of their boards or managers. Instead, they join other individuals in the market and create pressure for performance through their collective short-term decisions to buy or sell stock. The governance of public companies reflects this paradigm of inactive but mobile shareholders creating market pressures for performance.

Public companies have independent boards that act primarily as fiduciaries, or agents, of potentially mobile shareholder interests. These boards operate under the paradigm of maximizing near-term share value in order to sustain and expand their pool of shareholders. Market demand for the company stock is the primary measure of success, and this market fluctuates daily based on the fluid relationship of many economic factors, both inside

and outside of the company. Because of this, the board of directors is the locus of power in the governance of public companies. The board is charged with the oversight of management and must ensure that management is creating value that will be recognized in the market.

In widely held public companies, management is often perceived as self-interested. Active governance is seen as necessary to curbing potential management abuses, as well as to assuring the effective alignment of management interests and shareholder interests. The boards of public companies spend a great deal of time and effort designing systems to control and monitor management activities and compensation, reinforcing a potentially adversarial relationship. In addition, boards and their practices are under increasing scrutiny today, and many new laws and regulations are being written to reform the governance of public companies. Many of these laws are designed to strengthen the independence of boards and increase their accountability.

As the boards of public companies become more independent and powerful, the expectation that they should provide more than oversight increases, as does the expectation that they should actively direct management on behalf of ownership interests. However, boards focused on corporate performance and share value can become averse to taking risks that may have significant short-term impacts. They can become captive to the conventional wisdom of the market and forgo more unconventional strategies that might better capture long-term value in their unique market segment. Often, management is better positioned to see how dynamic new strategies will create value for customers and improve business performance. Unfortunately, the governance paradigm of public companies does not always enable the pursuit of creative new business strategies.

HOW GOVERNANCE DIFFERS IN FAMILY COMPANIES

Family business governance systems are more uniquely suited to the pursuit of unconventional strategies. Family businesses can more readily bypass the adversarial qualities of conventional business governance. Ownership can exert influence and care on multiple levels, making the family an agent of more effective decision making in management, on the board, and among owners. Rather than functioning as a costly system of checks and balances, governance in family firms often serves to enable transparency and partnership across the system. This, in turn, can enable the pursuit of strategies that are



Russ & Daughters' landmark store on New York City's lower east side. Established in 1914, the business has been run by four generations of the Russ family. (Photo courtesy of russanddaughters.com)

potentially more productive in the long term, despite short-term costs or risks.

Conventional business governance often focuses on establishing boundaries and defining the separation of decision-making powers. In contrast, family business governance is often focused on establishing productive, procedural engagement across the system. Practices that provide for simultaneous consultations among owners, directors, and managers permit a freer flow of ideas as well as speedier decision making. They also contribute to an ongoing alignment of interests and objectives over time.

The active participation of owners is the key to effective family business governance. Family ownership defines the values, vision, and objectives of the business. It articulates the financial goals and performance expectations that guide board and management decisions. Owners also provide an overall vision of the company that generally defines a business strategy. This clarifies and focuses objectives across the system and helps set appropriate strategic constraints on board and management decisions.

But establishing a clear, shared understanding of

the separate functions of the ownership, board, and management also is vital to effective family business governance—all the more so because family members often wear multiple hats, functioning as owners, directors, and managers.

While the direct involvement of the family on multiple levels complicates the system, it also provides an important link between the different areas of governance. This built-in link, combined with a positive development of family ties and relationships, can fundamentally change the dynamic of trust that pervades the governance system. A well-functioning system helps build trust within the family, and a good family dynamic, in turn, becomes an asset to the business because it enables each separate piece of governance to function better and add more value while remaining aligned with the other components of the governance system.

STAGES OF FAMILY BUSINESS DEVELOPMENT

Most family businesses begin with an entrepreneurial founder. Initially, the founder embodies the governance system, being the all-powerful owner and operator of the business. Founders sometimes make use of advisory boards, but they generally retain all decision rights. In many cases, the chief challenge of founders is deciding how to sustain their family business through succession. Some founders seek a single heir who can re-create the concentrated power of the owner-operator. More, however, see the business as a collective inheritance and divide it among members of the family.

When ownership passes down across generations, it passes through distinct stages. The first stage is the sibling or family partnership, with parents sharing ownership with their children. Eventually, the involvement of the parents ends, and the siblings come to share ownership in a partnership spirit. They must decide among themselves how to govern the business; often, this is described as the “kitchen table” period. The siblings can sit down together and consult informally, and sometimes they form a board to help build consensus for strategy. Roles may begin to separate at this stage, as some siblings may be active in the business while others are not. From this point on, the level of trust in the family often determines how formal governance practice becomes.

The third generation succession often involves a diverse group of cousins. This generally changes the scale of the family and differentiates family roles further. Family members may continue to be involved in management, the board, and ownership. Ownership

holdings can become increasingly variable in size, with some remaining quite concentrated. Family members can be active to varying degrees in the business and governance, and their level of involvement may not necessarily reflect their level of economic interest. These complications generally lead to the development of more formal governance practice. When majority ownership moves outside of management, the board will often take on more of a fiduciary characteristic. The extent to which trust is cultivated directly between the controlling owners and the leaders of management often determines how formal governance practice becomes at this stage and whether the family can continue to create effective agency in governance.

The next family succession causes another significant change in ownership scale. At this stage, the development of family governance, which functions in parallel to business governance, is often an added feature of an increasingly formal and complex governance system. Family members may continue to be involved across the governance system, linking ownership, the board, and management. Often, the business at this stage has become a holding company, creating the need for a board that can strategically manage a portfolio of businesses.

THE EVOLUTION OF FAMILY BUSINESS GOVERNANCE

As a business grows, it becomes increasingly complex, creating its own demands for a more formal organizational structure. While adapting governance practices to the emerging needs of families and businesses as they grow is a very complex and challenging endeavor,

over time it is also unavoidable. Success drives the need to adapt and change. At certain stages, business or family growth will tend to become exponential. All family businesses eventually face this reality.

Because family and business life cycles often challenge the effectiveness of existing governance practices, family businesses are actually quite attentive to adapting their practices over time. With each generation of succession or change in business scale, family companies are often confronted with the need to re-create their business governance. Family business life cycles can lead to fundamental changes in the roles, functions, and practices of the governance system. Faced with the dilemmas of change, families frequently study current best business practices. However, rather than simply adopting prescriptive best practices, families tend to adapt practices to their historic business culture, and so renew the effectiveness of their governance agency over time. ■

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KEY OECD PRINCIPLES OF CORPORATE GOVERNANCE

I. Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

II. The rights of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

III. The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

IV. The role of stakeholders in corporate governance

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

V. Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

VI. The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

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INTERNET RESOURCES

Online resources for information about corporate governance

UNITED STATES GOVERNMENT

U.S. Agency for International Development
http://www.usaid.gov/our_work/democracy_and_governance/technical_areas/anti-corruption/

U.S. Department of Justice
<http://www.usdoj.gov/criminal/fraud.html>

U.S. Securities and Exchange Commission
<http://www.sec.gov/>

The White House
<http://www.whitehouse.gov/infocus/corporateresponsibility/>

INTERNATIONAL AND NON-GOVERNMENTAL ORGANIZATIONS

Asian Institute of Corporate Governance
<http://www.aicg.org/>

Center for International Private Enterprise
http://www.cipe.org/programs/corp_gov/index.htm

The Conference Board
<http://www.conference-board.org/knowledge/governance.cfm>

Corporate Governance
<http://www.corpgov.net/>

The Corporate Governance Encyclopedia
<http://www.encycogov.com/>

Corporate Governance Quotient
http://www.isscgq.com/gcgq/g_central.asp

The Corporate Library
<http://www.thecorporatelibrary.com/>

European Corporate Governance Institute
<http://www.ecgi.org/>

Global Corporate Governance Forum
<http://www.gcgf.org/index.htm>

Institutional Shareholder Services
<http://www.issproxy.com/>

International Chamber of Commerce – Corporate Governance
<http://www.iccwbo.org/cg.htm>

International Corporate Governance Network
<http://www.icgn.org/>

Investor Responsibility Research Center
<http://www.irrc.org/>

National Association of Corporate Directors
<http://www.nacdonline.org/>

OECD – Corporate Governance
http://www.oecd.org/topic/0,2686,en_2649_37439_1_1_1_1_37439,00.html

World Council for Corporate Governance
<http://www.wcfcg.net/index.htm>

Yale University, International Institute for Corporate Governance
<http://iicg.som.yale.edu/links/links.shtml>

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